

BY JOHN A. GORMAN

Financing the Expansion of GNP in The Current Cyclical Move

THE DYNAMIC advance in the economy has resulted in a heavy demand for financing. Credit growth to meet this demand has been dampened by the inelasticity of lendable savings as well as by a monetary policy designed to make for orderly progress and to restrain inflationary tendencies. With the supply of money restricted, more effective use was made of it; evidence of this is provided by the increase in the velocity of circulation, which rose to a postwar high. Interest rates advanced, reaching the highest level in three decades as the current year opened.

Credit eases since January

The sharp advance in economic activity around the turn of the year was followed by some leveling out; credit conditions eased in recent months, owing in part to seasonal influences and in part to more basic changes. This easing was evidenced most clearly by a reduction of interest rates from the highs of late December and early January. In recent weeks these rates have shown some firming, but current yields are still under the year-end highs. Treasury bill rates are off from 4.67 to a mid-May figure of 3.79, and the average rate on bank loans has dipped. Among longer-term issues, both Treasury and corporate bond yields are fractionally lower.

After the year-end spurt, inventory accumulation moderated somewhat the extraordinary pace set following the steel strike. This slowing of the economic advance was conducive to a leveling out in the many credit demands that are associated with expansion in economic activity.

The shift of the Federal budget from a deficit to a surplus position has also contributed to a substantial decline in the demand for loanable funds. The situation is less clear with respect to other sources of demand which had exerted upward pressure on interest rates during 1959. There is some indication

that the demand for long-term funds has tended to ease, at least temporarily, though the demand for business loans and consumer credit continues very strong.

The recent softening of interest rates is probably in part the reflection also of a shift this year in economic anticipations, though this is a factor not subject to quantitative appraisal. The trend of activity in some parts of the economy in the wake of the steel strike has no doubt been less buoyant than had been expected by some. The demands for output have been less insistent, and the refilling of pipelines which was necessary before they could be satisfied proceeded much more promptly than had been thought possible. Partly as a result of these developments, several manufacturing lines have experienced some narrowing of profit margins.

The movement of the stock market has unquestionably been a factor in the change of business climate, although here causes and effects can hardly be disentangled. By the end of the first quarter the SEC index of common stock prices, which had risen during most of 1959, had about canceled all of last year's advance, and in April the easing tendency continued. The ratio of stock prices to earnings has receded from its

1959 peak, but remains much higher than in other postwar years.

The upswing since the spring of 1958 in real GNP—dollar value adjusted for the price advance—has matched closely the rise of the corresponding period of the preceding cyclical expansion, if allowance is made for the effects of the 1959 steel strike. The two periods are compared in the adjacent chart.

Price movements have also been like those of 1954-55. Prices generally showed only a limited advance in each case, as overall production capacity was generally ample in relation to demand in both periods. Last year, as in 1955, a downward movement in prices of farm products offset much of the rise in other products and contributed to the relative stability of the overall averages.

Monetary and credit conditions were more restrictive last year. In the virtual absence of monetary expansion, substantial economies were made in the use of cash balances—as evidenced by the earlier-mentioned rise in the income velocity of circulation. By limiting the funds available in markets for the national output which rely on credit financing, last year's monetary policy was designed to keep the expansion orderly under conditions of relative price stability. As in the previous cycle, credit restraint had differential effects, but the major visible one appeared in the course of residential construction activity, the restricted availability of mortgage credit having contributed to the decline in building after midyear.

Financial Requirements and Supplies

THE NEEDS for financing expanded rapidly with the upswing of economic activity. This called for large increases in external financing—debt and equity—and for ploughing back a large part of the increased earnings. The major institutions and groups engaged in supplying loan funds were not in a position to meet calls made on them, without the development of considerable financial stringency. The rise of interest rates under existing supply-

demand conditions was particularly marked in the case of short-term obligations, where demand pressures were heaviest.

The expansion in requirements, the positions of lenders, and the factors affecting interest rates will be reviewed in turn.

Needs Up With GNP Advance

The cyclical rise in production and sales involved a substantial increase in

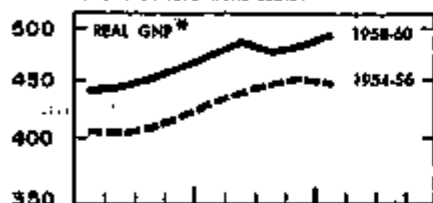
business working capital requirements, including credit to customers. In addition, it was accompanied by a step-up in plant and equipment outlays.

These demands for capital were met in part from internal sources—from

Economic Expansion of 1958-60 Compared With 1954-56 Advance

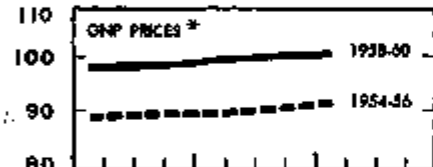
Similar progress in each case in REAL GNP

Billion (1959) Dollars (ratio scale)



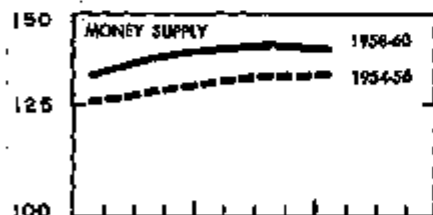
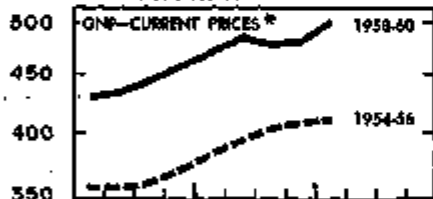
and in the movement of PRICES
of goods and services

1959=100 (ratio scale)



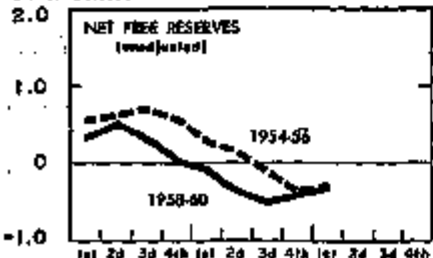
The MONEY SUPPLY was lower this
time in relation to GNP, and did not
advance in 1959

Billion Dollars (ratio scale)



BANK RESOURCES were under
pressure from the Federal Reserve
and were used more fully ...

Billion Dollars



* Quarterly Totals, at Annual Rate

U. S. Department of Commerce, Office of Business Economics

earnings and from the rising sums set aside out of receipts to provide for depreciation. As usual in good times, however, attractive opportunities for the use of available funds tended to outstrip the growth of current saving, and outside financing was sought for a large volume of business needs.

Consumers, too, called for more loans to finance their heavy purchases of dwellings and durable goods. The Federal Government had to cover an expected budgetary deficit of considerable size for the year as a whole, and State and local governments continued to borrow large amounts to pay for their construction programs.

For some desired uses, of course, not all the sums called for could be secured. The demand pressures operative in the money and capital markets are accordingly reflected only in part in the record of amounts actually obtained and used by those successful in satisfying their requirements.

Business fixed and working capital up

Customer credit needs vary with sales of goods, and so does the amount of inventory to be carried. The changes in financial requirements for these purposes are very sharp. Though these changes tend toward zero when business is stable, they shift rapidly in adjustments to new levels of activity. A substantial buildup in inventories occurred in the course of 1959 despite the steel strike and the indicated credit stringency, and there was a marked rise in short-term receivables on the books of business enterprises. These increases in working capital were financed in substantial part from borrowings; to-

gether they represented the largest single element in the rise of demand for financing.

Business outlays for plant and producers' equipment amounted to a sum about equal to that added to gross working capital in 1959, but in this instance the step-up from 1958 was relatively much less. The recovery of fixed investment tended to lag behind the cyclical advance, as it has in other postwar swings of economic activity. Most of the capital needed, moreover, was drawn from internal sources. This was partly because the expansion in long-term requirements centered in industries which typically rely to a great extent on retained earnings and depreciation reserves as major current sources of capital.

In sum, the rise in business needs for external financing was mostly short-term in character. Demand for long-term funds from outside sources continued high, but was down somewhat from 1958.

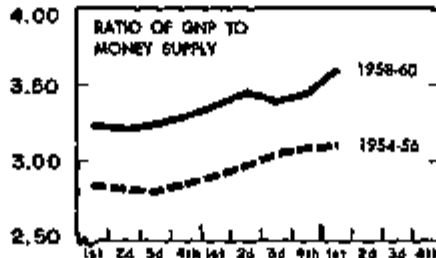
More durable goods

Expanded needs for consumer financing accompanied the sharply increased purchases of autos, other durable goods, and dwellings. These commonly involve downpayments out of the purchasers' prior savings. On the whole, however, the greater part of the sums used for these large purchases are borrowed. Consumer installment paper and mortgage debt originating in such transactions have been major outlets for loanable funds in almost every postwar year.

The growth of durable goods sales last year, moreover, centered in auto-

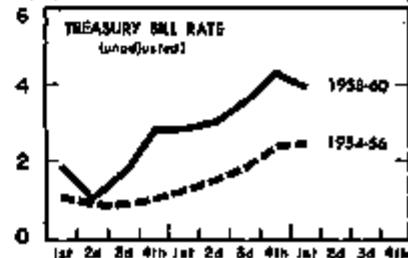
and so were money balances (currency and bank deposits) of individuals and businesses, raising CIRCULATION VELOCITY to a postwar peak

Ratio



INTEREST RATES advanced more in
recent period—to postwar highs

Percent



Seasonally adjusted data, FRB, U.S. Treasury, and OBE
50-6-11

mobiles, and these make especially heavy demands on the available credit. The rise in short-term consumer financing outpaced the one-seventh expansion in total sales of these goods.

Residential construction was growing through most of 1958. Though activity leveled off and turned down after mid-1959, it reached a total for the year almost one-fourth larger than the year before. The associated upswing in the new long-term financial requirements of the Nation's families was the sharpest indicated for any group active in the capital market last year.

Government needs large last year

The Federal Government, which had been a major borrower in 1958 as the business recession led to a substantial budgetary deficit, again entered the money market on a large scale last year. The Treasury's need for loan funds in 1959 arose from three principal causes.

First, though the business situation and with it the Federal fiscal position were much improved as compared with 1958, the national income and product account still showed a deficit for the calendar year.

Secondly, the fiscal improvement centered in considerable part in the yield of the corporation income tax, which was up as corporate profits rebounded from their 1958 low. Much of the increase, however, did not show up in collections until after the end of the calendar year. Largely for this reason, accrued corporate tax receivables outstanding at the 1959 yearend were up \$3 billion. Besides covering a deficit that amounted on an accrual basis to \$2 billion, the Treasury's borrowings had temporarily to cover this \$3 billion difference also, pending receipt of these taxes.

Finally, close to \$3 billion was needed to finance the Government's lending during the year under its various housing programs.

These three items were the major elements in the \$8 billion "cash-budget" deficit incurred by the Federal Government last year. All of them were short-term in character, and the last two of them involved the temporary supplying of substantial sums elsewhere in the money and capital markets, so that

their effect was partly offset in these markets (see next section).

Long-term governmental borrowing last year reflected basically the financial requirements of State and local construction, which expanded in 1959 as throughout the postwar period. Last year's increase was mainly in roadbuilding, and the dollar rise here was for the most part met by an increase in grants received from the Federal Highway Trust Fund. Apart from these grant aid receipts, long-term uses aggregated about the same as in 1958.

Position of Lenders

Monetary policy was a major factor in last year's financial situation, as the shift from the easy money policy which had been employed in 1958 to combat the recession was already apparent before the beginning of 1959. The move toward restraint extended throughout last year, its effects becoming increasingly noticeable as the business upswing and the attendant rise in financial needs continued.

The position was signaled by the course of Federal Reserve Bank discount rates. From less than 2 percent in the spring of 1958, these moved up to 2½ percent before yearend, to 3½ percent by mid-1959, and to 4 percent last fall.

Open market operations during 1959 served primarily to offset seasonal shifts in demand, and to counter in part the effects of the flow of gold to foreign holders, most of which occurred in the spring and summer. The volume of legal reserves was about the same at the end of 1959 as at the beginning, despite a rise in member bank debt to the Federal Reserve Banks. The available reserves were being used more intensively, however—as was illustrated in a relatively high and rising total of commercial banks' borrowings from one another—and total demand deposits increased fractionally.¹ Transactions demand for means of payment, as reflected in GNP and in bank debits, by contrast, rose sharply during the year.

During 1958, there had been a build-up of demand deposits. As compared to the prerecession first half of 1957, deposits in 1959 averaged 5 percent

higher; GNP was up 4 percent in real terms and 9 percent in value.

New resources low, banks shift portfolios

Monetary expansion thus played only a minor role among the fund sources available to the banking system last year, providing less than \$1 billion. Time deposits, which had risen substantially during 1958, increased about \$2 billion further in the course of 1959. Advances from the Reserve Banks, totaling \$½ billion as 1959 opened, moved up to reach \$1 billion in the summer and remained near that figure—one of the highest of the decade—through the remainder of the year. Finally, the banks' retained net earnings totaled about \$½ billion, and a like sum was realized from new stock issues. These inflows together made possible an expansion of around \$5 billion in loans and investments.

This amount fell far short of meeting the calls by the banks' customers for working capital and other loans. In order to accommodate these customers and secure the higher rates of yield obtainable, commercial banks liquidated \$8 billion of Government securities.

Savings flow to other institutions limited

The operations of sales finance companies as middlemen of credit played an important role last year. The companies borrowed \$1 billion from the banks, and raised close to \$1 billion by issuing intermediate-term market securities. With these sums they helped to meet the needs of consumers, and that of distributors and others for additional working capital.

Other types of financial institutions draw their capital funds mainly from personal saving. A dominant factor in their financial position during 1959 was the comparatively limited size of the inflow from this source. Total personal saving for the year was not greatly different from 1958, and the portion of it which was channeled through these institutional lenders remained stable in the aggregate.

1. The 5 percent reserve requirement on the expanded volume of time deposits noted below was also met by the improved efficiency with which reserves were used.

The pattern of funds supplied by the financial intermediaries reflected not only the limitations of their sources but also a general tendency to shift the makeup of portfolios. This tendency was in the same direction noted for the banks—increasing the fraction of relatively higher-yielding but less liquid instruments in the total. Cash holdings were reduced or Treasury obligations were sold and holdings of mortgages, corporate and State and local securities were built up.

Insurance companies and savings and loan associations obtained an increased fraction of the total going to savings institutions.

The insurance companies continued to invest mainly in mortgages and in corporate bonds, absorbing a somewhat larger proportion of the bonds coming on the market than they had in most prior years. They increased their purchases of State and local issues while at the same time switching out of Federal securities. The value of the tax-exemption feature of the municipals was underlined last year by new Federal legislation which increased the companies' income taxes.

Savings and loan associations offered higher interest rates and continued to advertise for new share capital. The sums realized, though up from 1958, fell short of covering their mortgage loan commitments, however, and the associations filled the gap by substantial borrowings from the Federal Home Loan Banks. The distribution of legal reserves between cash items and Treasury securities was adjusted to increase the proportion of higher-yielding assets in the total.

Mutual savings banks, with net new deposits down from 1958, contributed less than usual to the supply of long-term credit. Their new mortgage lending was made possible in part by the liquidation of Treasury securities.

Unlike most of the lender groups mentioned above, the major institutional suppliers of equity capital stepped up their rate of growth last year. Pension fund reserves increased as employer contributions rose with expanding business activity. These funds placed a somewhat larger fraction of the increment in stocks than the year before, accelerating their recent trend to

equities. Mutual investment companies experienced a substantial rise in available resources, most of which went into stocks.

Business and individual investors use own savings

With the prospects for business sales and family incomes considered good, in general both business firms and private households found their own activities providing attractive outlets for any excess funds on hand. For businesses, the rise in working capital needs has already been noted; and elsewhere the upsurge of residential and auto purchases limited the growth in new loan funds supplied by individual savers. The inclination to invest in market-type debt instruments was correspondingly limited.

Rates of return on such instruments, including Treasury obligations, advanced under the prevailing circumstances, and attracted a heavy volume of funds from corporations and individual investors.

The choices of both corporate and personal investors among financial opportunities not connected with their own operations reflected such yield increases, and fell consistently into a pattern of shift toward potentially higher-yielding though generally less liquid types of assets, such as might reasonably be preferred in periods of business prosperity.

Government supplies new credit

State and local employee pension and investment fund accumulations supplied around \$2½ billion to the long-term security markets last year.

The Federal Government too played a key role on the supply side of the money and capital markets, as well as on the demand side. First, the credit extended under the housing programs led to a considerable easing of the pressure on the mortgage market in 1958 and helped to limit the stringency that developed in 1959.

Second, the 1958-59 increase in corporation tax accruals was in effect loaned temporarily to corporate business pending collection of these taxes. The liability was reflected in the growth of tax reserves. These were employed in part as working capital and in part

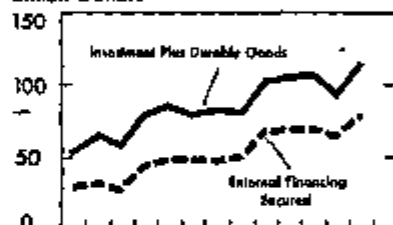
as liquid reserves. Use of them to meet working capital needs allowed the companies to limit their borrowing for such purposes; and their use to purchase tax anticipation bills and other market securities eased the fund supply situation in the security markets involved.

In these ways some of the amounts borrowed by the Federal Government last year found their way back into the financial markets. Putting the Government's lending activities together with its borrowings, it appears that the

EXTERNAL FINANCING of Private Investment and Consumer Purchases of Durable Goods

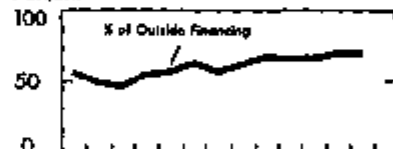
Demand for funds moves up—
with market expansion . . .

Billion Dollars



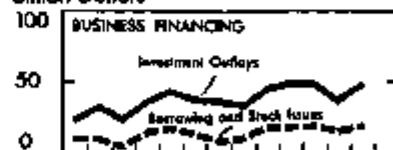
and need for more funds from
external sources

Percent

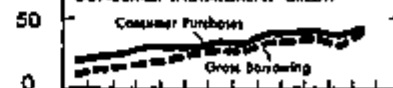


Funds required vary with activity

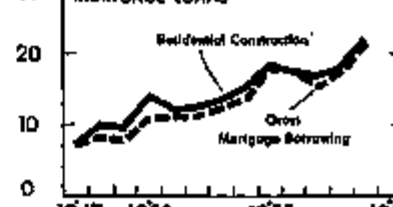
Billion Dollars



CONSUMER INSTALLMENT CREDIT



MORTGAGE LOANS



Basic Data: SEC, FRB, OGC

U. S. Department of Commerce, Office of Business Economics EO-5-12

net drain of the latter on the total supply of loanable funds was considerably less than the size of the sums borrowed would suggest.

Foreigners invest in U.S. securities

In 1959, as in 1958, the various factors which determine the international balance of payments combined to provide nonresidents with a substantial volume of claims on the United States. Foreign central banks and other investors employed these addi-

tional resources differently last year, however. Instead of accumulating gold and deposits, nonresidents channeled their new dollar holdings largely into short-term Treasury securities and other earning assets.

This shift meant an increase in the total made available by foreigners to help finance the domestic economic expansion, and tended to mitigate the impact of the adverse balance of payments on the financial markets.

Interest Rates and Security Prices

INTEREST rates and bond yields, which had turned upward in the second half of 1958, rose to the highest point reached for many years. Aside from the basic factors discussed earlier, the level and pattern of yields were also influenced by the economic expectations that featured the period. With the general tendency of business clearly upward and plain signs that a monetary policy of restraint was being followed, both borrowers and lenders recognized the likelihood of tightening credit and firming interest rates. The belief was expressed also by some that the economic advance would be accompanied by a degree of price inflation stemming from both the demand and cost sides. It was recognized too, as was pointed up in the regular analyses in the *Survey*, that our adverse international balance of payments was affecting our financial position.

These expectations are no doubt part of the explanation of the promptness with which interest rates rose after economic activity turned up two years ago. The prospects of good business at higher prices also helped to explain a general reduction of emphasis, in investors' portfolios, on instruments offering maximum security of principal values but relatively limited income or capital gain potentialities.

Short-term rates up sharply

The demand for loans was most insistent in connection with short and intermediate uses. The sharp expansion in inventories and in consumer and other trade paper has already been noted. The Federal borrowing was also concentrated in this area. The

supply of short-term funds was relatively restricted, owing in particular to the tightness in commercial bank reserve positions.

Aside from the needs to serve what were essentially short-term purposes, many borrowers resorted to the money market for the temporary financing of longer-term requirements. This tendency, reflecting a view that the current high yields on long-term obligations would not be maintained indefinitely, was a reversal of the tendency to fund floating debt which had been noted the year before. In the first half of 1958, particularly, borrowers had taken advantage of the low prevailing yields on long-term securities to refinance substantial amounts of near-term obligations.

Treasury bill yields higher

The rise in short-term interest rates was particularly marked in the case of Treasury bills. Besides the general supply-demand conditions noted above, there were a number of special factors tending to raise the rates on short and immediate-term Treasury securities.

One of these stemmed from the 4½ percent statutory rate ceiling on longer-term (over 5 year) Federal securities. Under prevalent market conditions, financing continued to rely on shorter-maturity issues.

Moreover, several investor groups which in 1958 had absorbed large quantities of short-term Treasury obligations were in a relatively unfavorable position to do so last year, since their own needs and those of their business connections, under conditions of ex-

panding activity, were pressing heavily on their available funds. This was the case of the commercial banks and other financial institutions. It was also the case for many nonfinancial corporations.

There were circumstances, however, that made for substantial corporate purchasing of short-term Governments once the rates had moved sufficiently high. Anticipating the outlay of large sums for inventory rebuilding, fixed capital investment, and taxes, many concerns were accumulating ready reserves and arranging lines of credit during 1959. Highly liquid Treasury securities affording attractive yields served as a profitable interim investment for the ready reserves. These issues could also be used to advantage in holding credit lines open for later needs, the yield on the securities covering most of the interest cost of the loans.

Finally, the large supply of bills was absorbed in part by other investor groups not ordinarily using extensive sums in this way, and the change in their portfolio patterns, like the purchases by corporate business, came about only when yields moved high enough.

Rise in long-term rates

Long-term uses for capital, like the short-term uses, tended to outpace the expansion in external supplies last year. The pressure on interest rates, however, was relatively less marked in the capital than in the money markets. There were several reasons for this. The basic supply-demand imbalance appears to have been relatively less. As has been noted, the recovery in business fixed investment from the recession low was limited, and long-term needs of State and local governments were not much changed from those of 1958.

Flotation of long-term debt issues could be avoided by some firms, moreover, by resort to short-term financing until capital market conditions should become more favorable. In addition, the strength of public interest in the stock market as reflected in heavy trading and high prices for common stocks encouraged the use of equity financing in some cases.

While stock flotations continued on a restricted scale, the volume of trading

in seasoned equity issues was the highest since 1929. Stock prices, as measured by the SEC composite index, averaged one-fourth higher than during 1958. An irregular advance which began as 1958 opened carried the index to a peak last summer.

From the standpoint of investors, the general economic outlook tended to emphasize the prospect of capital gains, and hence to render equities more attractive while reducing the appeal of most debt instruments.

Postwar rise in interest

The recent movements in interest rates are better understood when viewed in the longer perspective of the upward trend which marked the decade of the 1950's.

In this period the demand for capital funds has been strong, mirroring the high and rising volume of attractive opportunities for investment; the supply side, reflecting the more gradual uptrend of saving, has been strongly affected also by the gradual working off of the great liquidity which stemmed from the monetary and credit policies pursued during the Depression and subsequently in World War II.

In the earlier postwar years this liquidity obviated a good deal of borrowing which might otherwise have been required to finance the high investment activity, and at the same time it encouraged and facilitated lending.

In the course of the postwar period liquidity has declined as the economy has grown, the general price level has risen, and the accumulation of borrowings has raised the total of private and public debt.

Another factor in the rise of interest rates in the 1950s was the termination of the easy money policy which centered around the pegging of Federal security prices. This was superseded by a more flexible policy after the accord reached in March 1951 between the Treasury and the Federal Reserve authorities, leaving the Reserve free to fight inflation and deflation by regulating the money supply in ways that might affect the cost of Federal and other borrowing.

A third set of developments making for higher interest rates in this country as wartime dislocations receded into the past has been the renewal of effective

competition in the international financial markets. Such competition has tended to carry interest rates in the United States up, towards closer alignment with those prevailing abroad. The widespread foreign restrictions on the international movement of capital and of property income which had

grown up during the years of depression, war and readjustment have gradually been relaxed. As time passed, too, the substantial risk differentials between U.S. and foreign interest rates have narrowed as some of the political and economic uncertainties abroad were cleared up.

Financing by Major Borrower Groups

THE GENERAL condition of the financial markets last year has been outlined above in terms of the major supply and demand factors and the course of interest rates.

The broadest of the financial flows which resulted, in the existing situation of stability in the money supply and increasingly intensive use of cash balances, may be summarized as follows.

Nonfinancial corporations obtained large sums from bank and trade sources, the expansion in trade credit being particularly marked. Individuals stepped up their mortgage and other borrowing from financial institutions. Superimposed on these heavy private borrowings was a volume of bill, certificate, and note issues by the Federal Treasury which in total was among the highest ever recorded for a peacetime year.

With their own sources restricted as earlier noted, banks and other financial institutions obtained funds for their corporate and individual customers by liquidating Treasury obligations. The reduction in the holdings of these in 1959 canceled a large part of the build-up of the previous year. Under the selling pressure, yields on Government securities moved up, attracting from individuals, foreign buyers, and corporations the sums necessary to absorb the sell-off by financial institutions as well as the new securities issued by the Treasury.

The following sections deal separately with the spending and financing arrangements of the Federal Government and the other principal economic groups.

Corporate Finance

For the requirements of nonfinancial corporations noted earlier, the companies obtained a total of somewhat over \$54 billion last year. Over half

of this came from internal sources. Undistributed income totaled nearly \$10 billion for the year. Depreciation and other capital consumption allowances moved up in line with recent trends to provide \$21 billion.

Outside sources supplied an amount equalled only in the cyclically similar years 1950 and 1955. Short-term debt rose around \$17 billion, after having fallen in the recession. Long-term obligations were up almost \$6 billion, somewhat less than in 1958. The total obtained from stock issues, over \$2 billion, was larger than the year before.

The pattern of sources from which corporations obtained external funds last year may be summarized in terms of investor groups as follows. Trade credit received from suppliers of materials, etc., accounted for nearly half the total. Financial institutions provided most of the remainder, but roughly one-sixth was obtained from government—chiefly via the statutory lag between the accrual and collection of taxes.

There were the usual differences of source pattern as between short and long-term instruments. The near-term total included several billion advanced by commercial banks, in addition to the trade credit and tax reserves.

Long-term capital came as usual mainly from financial institutions. The volume of corporate bonds acquired by life insurance companies and private pension funds was little changed from 1958. Insurance companies and mutual savings banks stepped up their acquisitions of corporate mortgages. The volume of stocks issued by nonfinancial corporations (excluding investment and sales finance companies) was matched by purchases made for the portfolios of investment companies and pension funds. The dip in corporate long-term financing last year was reflected in

buying by individuals, who typically supply a small and variable fraction of the total.

The pattern of corporate needs and financing in 1959 was determined in large part by the industrial incidence of the business upswing and the financial arrangements typical of the industries concerned.

The expansion in capital requirements was most marked in lines which featured prominently in the economic rise from 1958—manufacturing, mining and trade. These industries generally count on internal sources for much of their long-term requirements. Their external financing is mostly to meet their short-term needs, and makes up the bulk of all near-term business borrowing.

Communications and public utility corporations, not much affected by swings in general business, required little additional working capital and actually reduced their spending on

fixed investment. The capital needs of these companies are typically met by borrowing and stock issues, and accounted for close to half of all long-term private capital issues in the 1950's.

The expanded real estate operations of corporate developers and others last year were mirrored in increases in both near-term construction loans and long-term mortgage borrowing.

Manufacturing and trade needs up

With last year's production rise centering in commodities, the flow of goods through manufacturing, mining, and trade firms rose sharply, and working capital requirements moved up accordingly. Both the advance reported in corporate inventory holdings and the rise in customer credit extensions were concentrated overwhelmingly in these industries.

Basically, the demand for credit for inventory expansion mirrored attempts to restore desired stock-sales ratios in the face of rising sales. During the first half there was superimposed on this a temporary demand that stemmed from hedging in anticipation of metals strikes. Metals stocks were drawn down during the second half, and overall ratios of durable goods inventories to GNP as 1960 began were still at relatively low levels. The inventory position for nondurables was easier.

Financial needs for fixed capital investment reflected a moderate increase from 1958 in manufacturing and mining programs, and a spurt in construction of shopping centers and other distribution facilities.

Most of the increase from 1958 in internal funds realized by corporate business occurred in these same industries. Higher sales and lessened unit labor requirements brought a sharp advance in the net income of manufacturing and trading firms. With dividends steady and tax rates unchanged, about half the pretax profits rise was ploughed back. Capital consumption allowances also rose.

As the supply of internal funds moved into better alignment with capital needs last year, these corporations reduced their long-term borrowing. The cutback was in public issues. Private placements held even, and

mortgage borrowing was stepped up with the rise in outlays for new commercial facilities.

Corporate manufacturers and distributors made extensive use of trade credit to help finance the expanded volume of their purchases from other firms. These two industry divisions accounted for virtually all the change in corporations' trade payables.

Both receivables and payables generally rose as goods passed through the production process. Companies operating in the earlier stages of production, e.g., mining and primary metals manufacturing, generally reported larger increases in receivables than in payables. Firms situated farther along in the flow of production to the final user, e.g., retail trade, showed the opposite pattern last year (allowing roughly for the float in payables).

This whole structure of trade credit extension was initially financed in large part by bank loans, to primary producing firms in particular.

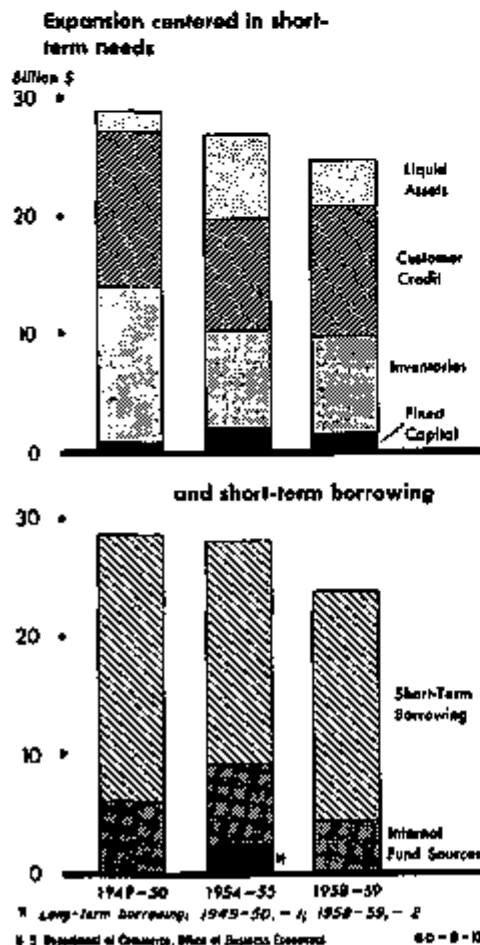
Such reliance on bank credit to finance an increased volume of production and support a multiple trade credit expansion has been a feature of each of our postwar recovery periods. In 1950 and 1955, the industrial pattern of trade credit extension and bank borrowing was similar to that noted last year.

Shift in public utility borrowing

The decline in capital outlays by the utilities last year, as in 1958, reflected the approaching completion of a major phase in these companies' postwar expansion. With customers' needs continuing to grow, substantial increases in fixed investment are programmed for 1960.

The investment cutback led to a tapering in capital issues, which are a chief source of funds for the utilities since these firms pay practically all their earnings out in dividends to stockholders. The dip in flotations was also attributable in part to the temporary short-term financing of capital needs which has been noted above. While bond and stock issues were off by \$½ billion each, bank loans to these industries were up by a like amount.

CORPORATE FINANCING in Three Business Recoveries



Personal and Unincorporated Business Finance

The major stimulus which individuals provided in the Nation's markets last year was their expanded buying of durable goods—autos, furniture, appliances, etc.—and residential housing. In addition, enterprises run by individuals or partnerships participated in the business inventory upswing, and increased their store and other fixed investment as well.

These purchases occasioned a marked expansion in the indebtedness of individuals and unincorporated enterprises. The sharpest relative increases were reported for consumer and short-term business debts, but home mortgage borrowing was the biggest absolute factor. It was \$13½ billion above repayments for the year, one-third more than in 1958. The total of farm, multifamily residential, and commercial mortgages also expanded substantially.

Consumer credit moves up

The rise in outlays for consumer durables was paced by auto sales, up one-fourth from 1958. Other categories of durable goods were also up, reflecting the growth of disposable income and consumer expectations of a further rise which made for ready borrowing.

Extensions of consumer installment credit were up \$7½ billion from 1958. This rise was offset in part by repayments but the net increase amounted to \$5½ billion. This increase, together with a \$1 billion rise in the total of charge accounts and single-payment loans outstanding, represented a consumer credit expansion of record proportions, matched only in the cyclically similar year 1955. By year end, the outstanding total of such debt aggregated over \$52 billion.

Unlike previous upswings in automobile credit, last year's net rise of about \$2½ billion was not associated with any substantial reduction in downpayments or lengthening of maturities. The growth in such loans stemmed from the sales rise, largely independent of credit terms.

Aside from the financing of durables, consumer credit needs reflected also the increase in installment buying of

other goods and of services. A special factor last year was the temporary stoppage of incomes due to the steel strike, which had substantial local effects.

Consumers' paper, carrying relatively high yields and being well secured in the aggregate by the trend of disposable income, has been a preferred investment for financial institutions handling such loans. Credit supplies were accordingly ample in 1959, as they have been throughout the postwar period.

Commercial bank holdings of such paper rose substantially, and the banks also helped finance an increase in sales and consumer finance companies' holdings. Other sources of consumer credit expansion last year included credit unions, department and other retail stores, and credit card plans.

Mortgage market changes

Purchases of new and older dwellings reached an all-time high in value last year. Reflecting the comparatively liberal terms on loan financing arranged in 1958 and early 1959, gross mortgage borrowing moved up in line with the purchases of dwellings.

At \$22 billion, new mortgage debts assumed by residential purchasers were up one-fifth over the previous peak year of 1955. Because of the cumulative character of such borrowing, larger and larger amounts are required annually for repayments, and these have represented a rising fraction of disposable income in recent years.

New mortgage funds obtained probably fell considerably short of what would have been used in the mortgage market had credit conditions not tightened though more basic factors have very likely contributed to the recent easing of housing construction activity.

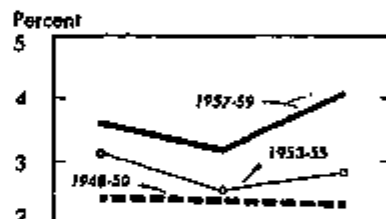
As the year 1959 progressed, interest rates and discounts rose; repayment periods were shortened; and funds were reported as inadequate, for Government-backed mortgages in particular, in many areas. The stringency developed as lenders specializing in mortgage credit found the inflow of saving to them leveling off, as described above, while the banks and other non-specialized lenders were attracted by more remunerative types of fund outlets.

Yields on conventional mortgages rose, on the average, from about 5½ percent late in 1958 to over 6½ percent at the end of last year. Effective rates on Government-backed mortgages likewise moved up strongly, data on FHA-insured loans showing one of the most rapid increases recorded during any recent year.

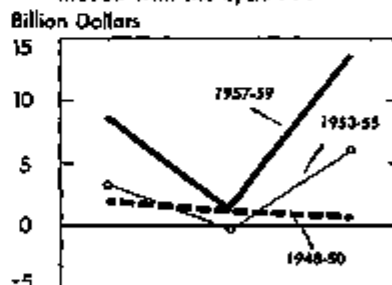
The net increase in home mortgage funds involved a \$4 billion rise in FHA-backed paper. Conventional mortgages, which have played a relatively larger role in the 1958-59 rise of construction than in the preceding upswing of 1954-55, supplied the other \$9½ billion.

Financial Assets of Individuals Shifted Differently in Three Postwar Cycles

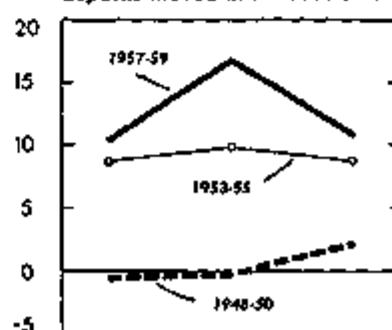
Since the return of more flexible interest rates in the 1950's . . .



Bond and stock purchases have moved with the cycle . . .



While demand and savings deposits moved in the reverse way



Note: Interest rates shown are averages of daily figures for June for taxable U.S. Treasury Bonds.

Data SEC

U.S. Department of Commerce, Office of Business Economics 60-5-14

To a large extent the shift to conventional financing reflected the preference of savings and loan associations for this type of mortgage, the associations having become more important in the mortgage lending field in recent years. An easing in downpayment requirements on conventional loans around the beginning of 1959 increased the attractiveness of such financing to home buyers. Finally, substantial and increasing discounts on federally underwritten paper made the latter less satisfactory to builders and homebuyers.

The institutional pattern of last year's increase in mortgage debt on 1 to 4-family dwellings is seen in the accompanying text table. The sources from which the various lender groups derived funds, and the portfolio adjustments made in connection with this lending, have been discussed earlier.

Noncorporate business expands

Persons operating noncorporate enterprises increased their financial commitments sharply last year. Fixed investment and inventory expansion in trade and agriculture and increased activity in real estate generated the principal additional demands for loans.

In trade, proprietors and partners added to inventories; purchases of stores and fixtures increased moderately.

Major Sources of 1959 Expansion in 1-4 Family Residential Mortgage Credit

(Billions of dollars)		
	Increase during 1959	Outstanding December 31, 1959
Total, all lenders.....	13.3	131.0
Savings and loan associations.....	6.8	49.7
Commercial banks.....	1.0	10.2
Mutual savings banks.....	1.2	10.3
Life insurance companies.....	1.2	23.5
Federal National Mortgage Association.....	1.4	4.9
Individuals and others.....	1.2	10.7

as well. Funds were obtained in substantial volume from banks and business suppliers and from the proprietors' savings, which expanded with higher business profits. The sharpness of the expansion in funds sought is suggested by the rise of over one-eighth in short-term obligations to banks and other financial institutions.

Farmers needed \$1 billion more to build up inventories, which increased in 1959 as during most of the past decade. Holdings of cattle and feed corn in particular expanded. The substantial purchasing of land, buildings and machinery, a feature of recent years

which involves considerable mortgage borrowing, also required taking on more debt. Overall, farm financing called for an increase of about \$1 billion in short-term production credit—mostly bank loans²—and of another \$1 billion in mortgage debt to banks, insurance companies and others.

Real estate borrowing reflected the accelerated pace of apartment house construction along with the continuing development of shopping centers.

Financial Position of Government

Though its fiscal position improved during the year, the Federal Government raised a total near \$9 billion in external funds. State and local governments borrowed another \$4 billion, on a net basis, continuing at a fairly steady rate their yearly additions to their outstanding debt.

The stability of Federal borrowing—despite the business improvement which sharply reduced the deficit—reflected mainly the increases in Government lending operations plus the fact that the full benefit of the 1958-59 rise in corporate income tax accruals was not reaped during the year.

Federal agencies contributed close to one-fifth of the sum used by private lenders to finance the record expansion in residential mortgage debt. In particular, Government purchases of mortgages under the special assistance and secondary market programs of FNMA totaled \$1½ billion; and a rise of almost \$1 billion in Federal Home Loan Bank advances supported the increase in lending activity of savings and loan associations.

The buildup in business reserves for taxes accrued but not yet due approached \$3 billion last year, and these deferred liabilities, like trade credit, represented fund sources which helped meet the temporary needs of the companies.

Certain other factors reflected in Federal borrowing were technical in nature. About \$1½ billion subscribed to the International Monetary Fund was paid in the form of special notes; though included in the statistics on

Table 1.—Public and Private Debt, End of Calendar Year, 1955-59¹

	Net debt					Gross debt				
	1955	1956	1957	1958	1959	1955	1956	1957	1958	1959
Total public and private debt.....	872.3	787.5	728.4	779.7	840.4	788.4	821.2	804.1	913.1	966.9
Total public debt ²	209.8	208.1	271.1	283.0	308.8	345.0	358.5	354.2	387.8	384.4
Federal Government and agency.....	231.5	225.4	224.4	232.7	243.2	301.5	306.8	301.7	330.0	322.0
State and local governments ³	38.4	42.7	46.7	50.0	55.0	43.5	51.0	52.5	57.8	62.4
Total private debt.....	662.5	579.4	457.3	496.7	531.6	443.4	462.7	449.9	525.3	582.5
Corporations.....	212.1	231.7	240.7	256.7	281.7	261.0	274.0	228.4	305.0	325.3
Long-term.....	105.0	100.1	112.2	121.0	129.9	108.1	120.3	124.0	148.0	154.7
Short-term.....	122.2	131.7	128.5	135.7	151.7	152.9	153.7	104.4	157.0	170.6
Notes and accounts payable.....	92.8	70.3	72.0	72.7	84.4	76.4	84.4	67.1	87.3	101.2
Other.....	55.4	61.4	62.0	62.3	87.3	67.6	70.2	71.5	71.1	77.3
Individuals and unincorporated enterprises.....	190.4	207.7	221.5	240.4	265.8	190.4	207.7	221.5	240.4	265.8
Farms.....	15.8	19.5	20.3	22.7	22.7	15.8	19.5	20.3	22.7	22.7
Nonfarms.....	174.6	188.1	201.2	217.7	243.1	174.6	188.1	201.2	217.7	243.1
1-4 family mortgages.....	88.5	94.1	102.2	121.8	124.4	88.5	94.1	102.2	121.8	124.4
Other mortgages.....	24.9	27.2	29.4	32.8	35.4	24.9	27.2	29.4	32.8	35.4
Consumer.....	38.0	42.6	45.3	45.0	52.0	38.0	42.6	45.3	45.0	52.0
Commercial.....	12.4	13.3	13.2	14.1	15.8	12.4	13.3	13.2	14.1	15.8
Financial ⁴	11.6	11.1	11.1	12.8	13.4	11.6	11.1	11.1	12.8	13.4

1. Series shown in tables 1 to 3 in annual debt reports appearing in previous issues of the SURVEY are summarized above for the recent period. The full set of tables on public and private debt for 1955-59, is available on request. The definitions used are described in the October 1959 SURVEY. Estimates for the period from 1910 through 1954 appear in the September 1955 SURVEY, while data for the 1945-52 period are contained in the May 1957 SURVEY.

2. Includes categories of debt not subject to the statutory debt limit. Net Federal debt is defined as the gross debt outstanding less Federal Government securities held by Federal agencies and trust funds, and Federal agency securities held by the U.S. Treasury and other agencies. It thus equals Federal Government and agency debt held by the public. Details of Federal obligations may be found in the Treasury Bulletin.

3. Data for State and local governments are for June 30 of each year.

4. Long-term debt is defined as having an original maturity of 1 year or more from date of issue; short-term debt as having an original maturity of less than 1 year.

5. Comprises debt of farmers and farm cooperatives to institutional lenders and Federal Government lending agencies, and farm mortgage debt owed to individuals and others.

6. Comprises debt owed to banks for purchasing or carrying securities, customers' debt to brokers, and debt owed to life insurance companies by policyholders.

Source: U.S. Department of Agriculture, Agricultural Research Service; U.S. Department of the Treasury; Board of Governors of the Federal Reserve System; U.S. Department of Commerce, Bureau of the Census, and Office of Business Economics.

2. CCO loans included in Table 1, are excluded here in accordance with their treatment in the national income and product accounts.

Federal debt, and providing capital to the Fund, these have no immediate effect on the money market and are not reflected in the U.S. cash budget. In addition, the Government's bank deposit holdings were temporarily up \$4 billion as the year ended.

Federal borrowing

Apart from the special notes to the IMF, the Government obtained \$6½ billion of external funds by issuing Treasury securities, and \$2½ billion from agency issues.

During 1959, the structure of the Treasury debt shifted to increase the total of short and intermediate-term marketable instruments. Besides the run-up as some of the longer-term issues outstanding moved within 5 years of maturity, this advance reflected new issues floated during the year. The terms of these took into account the positions of fund suppliers as well as the barriers to longer-term financing which were imposed by existing legislation and market conditions. In general, the Treasury has relied primarily on short- and medium-term issues throughout the postwar period.

Short-term securities, principally bills, were issued in volume last year to tap the liquid funds of corporations and of

foreign banks and official institutions. In 1958, these groups had built up their bank deposits; and the foreign countries had also increased their gold holdings substantially. Attracted by the high yields offered on Treasury bills and certificates in 1959, both corporations and foreigners acquired substantial amounts of this type of security.

The issue of medium-term obligations was stepped up to attract individual investors. Particularly noteworthy was the \$2½ billion issue of 5 percent notes offered last October; individuals participated in the initial allocation of this to a wider extent than any other new offering since the end of the Second World War. These notes have gone to a premium since their issuance.

The flotation of new long-term Federal securities last year was minor, but banks and other financial institutions reduced their holdings by selling about \$2 billion net. Offered for sale at discounts ranging as high as 20 percent below par, the yields on these bonds made them attractive to individuals, State and local governments, and other investors here and abroad.

Economic Aid

(Continued from page 19)

and improvements, as well as foreign currencies for educational exchange programs. As the programs for sale of farm products developed, the equivalent of nearly \$1 billion in foreign currencies has been disbursed since 1955 for credits.

Most of these credits and many which represented dollar disbursements have been extended with options to repay in foreign currencies. Where the foreign currency was obtained under a sales agreement signed prior to mid-1958, the credit generally requires maintenance of dollar value, with an interest rate increase for any installment made in foreign currencies.

This protects the U.S. Government against exchange losses until the repayment is received, but if repayment is in the foreign currency and the Government has no immediate use for the currency, the funds accumulating abroad would be subject to subsequent depreciation. In order to avoid the interest differential, some countries with comparatively stable currencies made their repayments in dollars last year.

Since early last year, maintenance of value is generally no longer required on

State and local construction requirements, substantially unchanged last year, provided the major occasion for borrowing by these governments.

Some decline was recorded in drafts on outside sources. This seems to have been made possible by advance financing that had been undertaken in the relatively favorably capital market conditions of 1958—a sequence that was in line with previous experience. In each of our postwar cycles, the volume of municipal bond flotations moved up sharply during the period of low interest rates characteristic of the recession period, and liquid asset holdings spurted. With the recovery in economic activity and rise in interest rates, gross borrowing leveled off or declined, and States and municipalities drew down their liquid assets as project and operating needs required.

The loan funds raised during 1959 were obtained with the help of stepped-up purchases of these government obligations by individuals and life insurance companies. Other insurance companies also increased their rate of acquisitions, while commercial banks reduced their buying substantially.

loans disbursed in foreign currency. Thus, the outstanding indebtedness may be affected by any depreciation from the stated amount.

As of the end of 1959, however, only about \$2 billion of the outstanding indebtedness was subject to any form of local currency repayment.

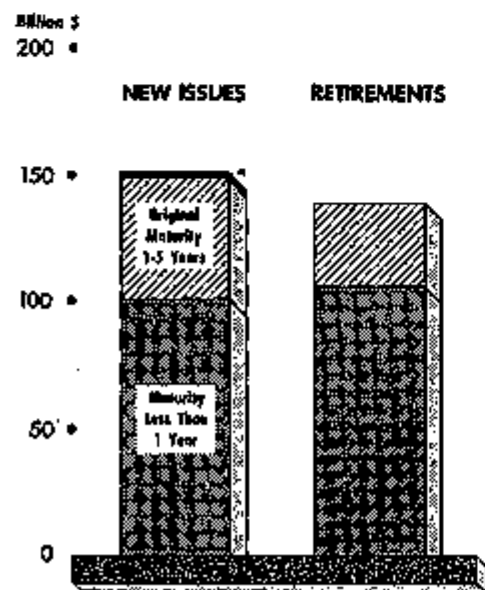
Short-term assets

The net short-term assistance, being the claims acquired less the value realized, does not necessarily reflect the actual value of the resulting asset, which by December 1959 had realized losses over 5 percent. Such losses—in effect a “grant” to the foreign country of real commodity resources (U.S. farm products)—remain in these data as permanent “short-term” assistance. Since about half of the \$2 billion asset is to be used for additional loans, and another significant part is to be used for grants and other transfer payments by the U.S. Government, only a limited part of this asset will be available for use by the U.S. Government.

At the end of 1959, the total assets of the Government in the form of, or payable in, foreign currencies, can be estimated at a maximum of \$4 billion. This is less than one-fifth of the Government's \$20 billion of foreign assets.

Treasury Financing in 1959

Increased the proportion of medium-term issues



* Maturity in excess of 5 years

Data: U.S. Treasury

U. S. Department of Commerce, Office of Business Economics

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